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Fund and games: loosening Europe's grip on the IMF

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Fund and games: loosening Europe's grip on the IMF

Abstract

Speculation last week that Paul Keating and Peter Costello could nominate for the top job at the International Monetary Fund (IMF) was a mere distraction, but the hoopla did manage to highlight a crucial issue: the need for reform at the top of the world's economic institutions.

Since Dominique Strauss-Kahn's dramatic exit from his post as IMF managing director earlier this month, much of the debate around his replacement has focused the need for a non-European to take the reins.

French Finance Minister Christine Lagarde has emerged as the frontrunner, despite a significant – and warranted – push from the developing economies to see one of their own win the job.

IMF has made it clear that the nomination process will be open and democratic, but if Lagarde's fast ascent is anything to go by, it seems that some long-standing conventions are proving difficult to break.

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Christine Lagarde is the favourite to become the IMF's new chief. AAP

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Battling history

An informal agreement between the US and the Europe finalised at the inaugural meeting of Board of Governors of the IMF and World Bank in Savannah, Georgia in March 1946 established that the US would select the head of the World Bank and the Europeans the IMF.

This agreement was the product of Cold War politics. John Maynard Keynes, who was head of the British delegation at Savannah, had lobbied to have Harry Dexter White, the US official most responsible for drafting the IMF and the World Bank's articles of agreement, appointed as the first Managing Director of the IMF.

However, US Treasury Secretary Fred Vinson did not have a good relationship with White and, one month prior to Savannah, had been given a FBI report by President Harry Truman naming White as a probable Soviet spy.

To block White, Vinson argued that the World Bank needed to be headed by an American to gain the confidence of Wall Street, where it would need to access funds for on-lending.

Further, he argued, it would be inappropriate for an American to head both the World Bank and the IMF, and thus a European should take the IMF role.

It turns out that White did have some relationship with Soviet intelligence. Nevertheless, the organisation produced from the negotiations between himself and Keynes were marked by their promotion of market-based, US-led global order.

Resisting change

After years of protesting by non-governmental organisations, activists and some governments from the Global South, Brazil in particular, the IMF in 2009 committed to “an open, merit-based and transparent process for the selection of IMF management.”

Boding ill for openness was the fact that the process for selecting the two deputy managing directors appointed since this commitment was not particularly open and transparent, and saw two G8-nation officials get the jobs.

Will the process that the IMF has announced for the new managing director be transparent? Well, sort of.

Only fund governors and executive directors can nominate candidates.

It will be merit-based. Well, again, sort of, because it will take into account the IMF's weighted voting system.

This is where countries' votes are proportional to the shares they have in the organisation and the shares are based on the size of each countries' economy.

It is this voting system that has been said to be at the heart of both the IMF and World Bank's democratic deficit. The countries that tend to utilise the IMF the most have the least say in management and direction.

These processes – and the range of statements coming out of Europe over the past couple of weeks making a case for another European head – highlight the enormous difficulty in truly reforming the international financial institutions.

The IMF and World Bank were created at a time when the US was hegemonic within the non-Communist world and there were far fewer nation-states in existence from which to obtain agreement.

Even then, creating the two organisations involved a whole series of compromises that narrowed the scope of their operations and increased the use of conditions. Once they were established, postwar economic chaos saw the IMF's mandate further limited and left the World Bank with limited funding for two decades.

It is one of the paradoxes of the Bretton Woods' twins that while critics rightly point to their high level of influence over developing countries, particularly those in crisis, in reality their influence over the international economic system seen as a whole, is limited.

This is even truer in the age of globalised finance. This is clear from an examination of the reforms made by Strauss-Kahn – the IMF's capital base was significantly expanded and there were some small changes to the voting shares of emerging and developing countries, but it still does not have enough resources to stabilise the global economic system should one of the G8 economies go bust.

IMF packages continue to subsidise the private financial institutions that hold the sovereign debt of crisis countries and, in effect, socialise their investment risks.

Hope for reform?

All this means I am sceptical about how much reform any new managing director can achieve.

Still, the role is important. Strauss-Kahn did achieve some short-term lifting of IMF conditionality and open up thinking about issues like capital controls in the IMF's influential research department.

Aside from Lagarde, Mexico's central bank governor Agustin Carstens is also in the running.

While it would be interesting to debate their respective strengths and weaknesses for the role, it is unlikely to be a useful pursuit.

Lagarde is clearly the frontrunner. The European Union has 32% of IMF votes. The US, with 16.7 per cent of the votes has been rather silent suggesting it wants to maintain its control over the World Bank top job and, despite the BRICs (Brazil, Russia, India and China) joint call for a transparent process, China has since indicated support for Lagarde.